January 2001, this temporary imposition of high costs on customers is particularly unnecessary. In fact, USTA estimates that, while price cap ILECs' SLCs and PICCs will begin to decrease before the year 2000, under the FCC plan, RoR ILECs' rates will continue to increase through the year 2001.[16] Under the FCC's plan, rural customers served by RoR ILECs, particularly multi-line business and non-primary residential line subscribers, will be significantly worse off than similar customers of price cap ILECs.

Further economic consequences of the SLC and PICC imposed according to the formulae of the price cap ILECs should be considered. Because the rate structure will hit business customers the hardest, business development in rural markets served by RoR ILECs could be deterred. Some businesses seeking the lower costs of locating in a rural community may be discouraged from investment in a community served by an RoR ILEC if the SLC and PICC rates are excessive. High telecommunications costs may outweigh other benefits to the business. In such an instance, a business may choose to locate in another rural community that would not have such high telecommunications costs. Such communities would likely include those served by larger, regionally-based ILECs that would likely have lower average prices than most RoR ILECs.

Presumably, the limitation of the customer impact of such cost disparities is the purpose of the universal service provisions of the 1996 Act. The 1996 Act states that consumers in "all regions of the nation" should have access to "reasonably comparable services . . . at rates . . . reasonably comparable" to those in urban areas.[17] If the SLC and the PICC are restructured according to the FCC's proposal prior to the resolution of universal service, RoR ILEC customers will have to pay significantly higher rates than those in price cap ILEC markets (including rural markets as we described above).

At the same time, rural ILEC customers purchase a lesser local service product than do other ILEC customers. Specifically, their local calling scopes are generally much smaller.[18] According to our analysis, 69 percent of subscribers in study areas containing less than 5,000 subscribers have

---

16 USTA Attachment B.

17 47 USC § 254(b)(3).

18 Some mid-size companies, however, are expanding local calling areas as a component of a rate rebalancing plan.

a toll-free calling scope of less than 5,000 lines. In contrast, in the largest study areas (with more than one million subscribers), 87 percent of subscribers have a toll-free calling scope greater than 50,000 subscribers. We have estimated that 37 percent of rural subscribers' minutes of calling are toll and 63 percent are local. For non-rural subscribers, 26 percent of minutes are toll and 74 percent are local. The widely different calling pattern for rural subscribers is explained by the different calling scopes. With the higher cost of SLCs and PICCs, based on the price cap ILEC formulae, RoR ILEC customers would pay a significantly higher rate for less of a product offering than urban subscribers would enjoy. The FCC must consider this incongruence as it determines how to implement the SLC and PICC for RoR ILECs.

PICCs set according to the formulae for price cap ILECs are problematic also because IXCs may choose not to average the PICCs nationwide. When fixed costs are shifted to the subscriber lines from access services, it is generally expected that subscribers would benefit from lower long distance rates. The most gain that RoR ILEC customers could expect to enjoy from this rate restructure, however, would result from nationwide averaging of PICCs by the IXCs. In this sense, RoR ILEC customers can expect to receive an "average gain," while their lines are assessed a "greater-than-average pain" in this rate restructuring. By appropriately modifying the formulae for setting SLCs and PICCs, the FCC could ensure that RoR ILEC customers bear no more than the "average pain" that customers in price cap ILEC markets are experiencing with the new rate structure. This is consistent with the 1996 Act.

Access reform for RoR ILECs automatically implicates universal service policy, because access pricing has been an integral element of meeting the goals of universal service. Access reform cannot, therefore, be conducted without consideration of universal service. The FCC has adopted a transition plan for rural ILECs and has determined to take no further action before January 1, 2001 at the earliest.[19] In light of this transition plan, the FCC should use different formulae for RoR ILECs than for price cap ILECs to avoid the rate shock to customers.[20] Specifically, as USTA

---

[19] NPRM at ¶ 6.

[20] NPRM at ¶ 40.

recommends, the FCC should cap rates for RoR ILEC SLCs and PICCs at the national average of price cap ILEC rates for those elements.[21]

III. The Importance of Pricing Flexibility

While the NPRM briefly promises to address pricing flexibility in a latter phase of this proceeding, the FCC should take action on pricing flexibility in conjunction with access reform. As we discussed above, a comprehensive approach toward access reform is necessary. RoR ILECs must be able to respond to competitive pressures they will increasingly face in the future. Pricing flexibility would also enable RoR ILECs to respond to those customers' whose needs go unmet in a rigid tariff environment. Regulators should use pricing flexibility to emulate results of a competitive market.

Telephone companies' prices have been structured to meet social objectives of universal service. For almost half a century regulators and the industry have struggled to reconcile this pricing structure with ever-expanding competition. While there was little competition for telecommunications services, regulators could impose pricing that did not consider incremental cost or demand responsiveness for individual services. However, prices under the current form of regulation do not emulate those in a competitive market.

Opponents of pricing flexibility argue that regulation is needed to guard against monopoly pricing, where effective competition does not exist. However, the current form of regulation does more to cause than to cure pricing inefficiency. Economically efficient rates, which competitive markets produce, cover incremental costs of production and respond to demand as perceived by the firm. For regulation to mimic the efficient results of a fully contestable market, it would need to account for variations in demand elasticities. They do not. The failure of regulation to yield

---

[21] USTA Comments at 12-15. Additionally, while the FCC's proposed rate structure provides a politically attractive way to improve economic efficiency by recovering non-traffic sensitive costs from non-traffic sensitive rates, USTA members assert that the proposed distinction between primary and non-primary lines will be administratively difficult to bill. In addition, there will be problems in dealing with customer claims that multiple lines to the same dwelling unit are all primary. For these reasons, USTA members recommend that the FCC not distinguish between primary and non-primary lines in applying SLCs and PICCs. USTA comments at 12-13.

demand-based pricing means that the rates that would occur in a perfectly functioning market do not, in fact, occur. This deviation skews the market and negatively impacts economic welfare.[22]

Efficient prices, on the other hand, encourage efficient competitive entry and allow carriers and customers to allocate their resources in an efficient manner. To achieve efficient pricing, most policy experts propose "rate rebalancing" in which the rates above incremental cost would be reduced toward their cost while rates below incremental cost would correspondingly increase. Rapid rate rebalancing, however, is politically unpalatable to most regulators, particularly where rural customers are concerned. Indeed, the purpose of the universal service fund is to alleviate the effect of these high costs on rural customers and to maintain comparability in urban and rural rates. To the extent that high costs in such markets are not recovered by universal service funding, RoR ILECs achieve affordable rates through access contributions. These high access contributions make RoR ILECs vulnerable to competition from competitive access providers (CAPs). Pricing flexibility is useful in allowing RoR ILECs to respond to this competition. Pricing flexibility is desirable in its own right, as well. It provides a feasible approach to achieving efficient pricing, and thus, emulating competitive market results.

The pricing flexibility that we envision requires broader thinking by regulators. Rather than continuing to prescribe the means by which certain categories of cost should be recovered, regulators should consider granting RoR ILECs greater latitude in establishing pricing options, subject to some "zone of reasonableness."[23] We have described, elsewhere, a proposal in which broad pricing flexibility for retail services would be made available, while some regulation of wholesale services, such as access, be retained.[24] Even if conditions of a pure monopoly held, affording RoR ILECs

---

[22] For further elaboration of this point, *see*, for example, J. Haring and J. Rohlfs, "Economic Perspectives on Access Reform," prepared for BellSouth Telecommunications, January 29, 1997.

[23] For a fuller exposition of relevant economic standards for reasonable pricing flexibility, *see* J. Haring and J. Rohlfs, "Comment on Pricing Flexibility Issues," prepared on behalf of BellSouth Telecommunications for submission before the FCC, *In the Matter of Price Cap Performance Review for Local Exchange Carriers*, CC Docket No. 94-1, January 10, 1996; and "Comments on 'Transition Issues,'" also prepared on behalf of BellSouth for submission in CC Docket No. 94-1, April 1994.

[24] *See* J. Haring and Harry M. Shooshan, III, "Cutting the Gordian Knot of Rate Rebalancing," presented at the Annual Conference of the Institute of Public Utilities, "Reconciling Competition and Regulation," Williamsburg, VA, December 5, 1997.

pricing flexibility within some "zone of reasonableness" constraint could be expected to improve economic efficiency.

Besides providing a means of emulating a competitive market, pricing flexibility enables RoR ILECs to meet customers' needs and respond to competition. The FCC has asked for comment on the impact of the 1996 Act provisions for rural exemptions and suspensions or modifications for "two percent" companies regarding interconnection obligations.[25] Presumably, the FCC is interested in whether local exchange competition will occur more slowly in markets served by such companies because of the ILECs' opportunities to provide a different degree of interconnection than that imposed on the largest ILECs. Few states have granted a suspension or modification of interconnection requirements to ILECs that fit the definition of "two percent" company. Only the relatively small companies that have sought to retain the rural exemption have been successful. State commissions have demonstrated no willingness to limit local competition in rural or "two percent" companies' markets in the presence of a competitor willing to enter the market.

State commissions cannot, however, restrict a competitor from entering any market without the use of an ILEC's unbundled network elements or wholesale service. A competitor may choose to deploy its own network, such as a fiber ring or an extension of its existing network (*i.e.*, from a PoP or another ILEC market near by). There is nothing in the rural exemption or suspension/modifications provisions to stop competition from occurring if a competitor finds it can make a profit by entering a market served by any ILEC, rural or not. No ILEC is exempt from the requirement to interconnect and exchange traffic.[26] The barriers to entry in markets served by rural and "two percent" telephone companies have been removed.

USTA members propose to publish a list of unbundled network elements available and provide number portability in a timely manner in return for the ability to price interstate services on an individual case basis and file contract tariffs for such services.[27] USTA's proposal helps the FCC

---

25 NPRM at ¶ 44.

26 47 USC §251(a). "Two percent" companies may seek suspension or modifications of §251(b), including reciprocal compensation, but that is not an exemption.

27 USTA Comments at 28-29.

further its goals of opening up local markets throughout the country in exchange for adopting a policy that is beneficial, in its own right.

Whether RoR ILECs face competition for local exchange services or whether they provide unbundled loops or wholesale services to competitive local exchange carriers (CLECs), however, is not of primary importance in this proceeding. When considering the regulation of interstate access services, the appropriate source of competition which the FCC must consider is that of CAPs, IXCs or other carriers that may easily extend their networks and provide access (perhaps together with other services, as described below). This may seem like backward thinking as the FCC has more recently concentrated on unbundling local exchange networks in larger markets. CAPs and IXCs, however, are among the most critical competitive risks to RoR ILECs. Such competitors need not purchase unbundled elements or wholesale services in order to win a significant portion of the revenues from an RoR ILEC. The availability of unbundled network elements and number portability only enhance the ability of competitors to operate successfully in RoR ILEC markets.

For example, rural ILECs obtain, on average, 60 percent of their revenues from access and universal service. Additionally, rural ILEC exchanges often have a few large customers that provide a significant proportion of the ILEC's total revenues. Also, an RoR ILEC serving only a concentrated geographic market cannot make up any competitive losses in one geographic market through pricing in another geographic market. As a result, the impact of competition is felt sharply and quickly by RoR ILECs.

The universal service impact of competitive entry in rural markets, regardless of the 1996 Act, can be problematic if rate rebalancing does not occur and pricing flexibility is not available to the ILEC. The CAP will likely seek to serve the few, large customers which it can most profitably serve. As the few large customers turn to lower-priced CAP services and the ILEC's prices are bid down, the implicit contribution generated from such customers erodes. The cost of the ILEC's network must be borne by the remaining small customers, mostly residential. The state commissions will have great responsibility in this area, but the FCC can and must do its part in this proceeding to avoid creating artificial incentives for entrants to serve only the most profitable customers in the market.

Federal regulatory flexibility need not await the arrival of a wireline local exchange competitor or a request for unbundled network elements or wholesale service. Even today, an IXC

may easily extend its network from a nearby PoP, and not only avoid access charges, but also gain the entire business of a large customer in a rural market. The ILEC consequently loses both access and retail revenues because it lacks pricing flexibility to develop a competitive proposal to retain at least some portion of the revenue lost.

For example, AT&T offers its long-distance customers a service, Digital Link, in which customers can combine outbound local, long-distance, and international service on AT&T T1.5, T45, or "ACCU-Ring" dedicated access services.[28] According to AT&T, implementing Digital Link is very simple. The customer's PBX just requires reprogramming to route local calls to AT&T's switch automatically. AT&T offers special promotions to reduce the reprogramming cost. AT&T offers Digital Link in 49 states, except Alaska and Washington, D.C. AT&T makes no distinction among urban, suburban or rural markets.

It appears that AT&T can easily offer Digital Link in any ILEC's market. One customer, the director of network services at Telxon Corporation, an electronics manufacturer based in California, described the product as very simple to implement and enjoyed the integrated services and billing offered by AT&T. The customer also noted that it purchased fewer trunks from the ILECs as a result of purchasing Digital Link. Recently, AT&T announced plans to upgrade Digital Link to enable customers to receive local calls and make toll-free calls. AT&T plans to make this feature available "throughout the country" by the end of next year.[29]

Based on AT&T's own description of and its customer's satisfaction with the Digital Link product, AT&T can easily and successfully provide local exchange service without purchasing unbundled elements or reselling an ILEC's local service. AT&T uses its own facilities and may simply need to exchange traffic with the ILEC. The ILEC loses the access revenues from AT&T and the revenues from local service and trunks previously provided to the customer. This product is not aimed solely at the largest customers. Even though the in-bound and toll-free calling capabilities may not be immediately available in smaller markets, it may be profitable for AT&T to make such an investment to serve a lucrative customer. Without pricing flexibility and a satisfactory resolution

---

[28] *See*, AT&T's web site at <http://www.att.com/att_digital_link/> and sub-pages for description and testimonial. Information obtained June 29, 1998.

[29] "AT&T Expands 'Digital Link' Local Business Offering," *Telecommunications Reports*, June 15, 1998, at 18.

to universal service issues, the RoR ILECs will have difficulty competing against AT&T for such customers.

A company should not have to wait until it faces such competition as Anchorage Telephone Utility (ATU) before it is granted relief. ATU, in Alaska, is an example of a company facing severe competition. ATU serves a concentrated urban market, faces competition for its access as well as local services. ATU has filed a petition with the FCC seeking authority to offer volume and term discounts for switched access services.[30] According to ATU's petition, it faces direct facilities-based competition from GCI, which provides local and long-distance telephone service, cable television, and data communication services throughout Alaska. GCI has constructed a fiber ring around Anchorage, providing high-speed data connectivity and the distribution network for GCI's local exchange services. GCI has equipment collocated in all seven of ATU's wire centers and has won the business of two statewide financial institutions, among other customers. ATU states that GCI is the largest telecommunications carrier in Alaska. GCI has undertaken many other activities such as linking Alaskan population centers with the lower forty-eight states and has won the LMDS license in the Anchorage BTA with which GCI intends to bypass ATU completely, including the local loop.[31]

Additionally, ATU has interconnected with AT&T Alascom, a subsidiary of AT&T. AT&T Alascom provides local exchange service to 10,000 customers in Anchorage through resale. GCI and AT&T Alascom are the two facilities-based IXCs in Alaska and ATU's primary access customers. As GCI builds its own network, it will rely less and less on ATU. GCI is also trying to lure AT&T Alascom to its network. Unlike ATU and other RoR ILECs, GCI may offer volume and term discounts. ATU can easily lose AT&T Alascom without the relief from the FCC that it now seeks. As a geographically-concentrated RoR ILEC, ATU cannot make up revenue shortfalls in other markets.

Not only should ATU be allowed to price flexibly, ATU should not have to endure the current Part 69 waiver process that the FCC developed to permit deviations from its rigid pricing

---

30 *In the Matter of ATU Telecommunications Request for Waiver of Sections 69.106(b) and 69.124(b)(1) of the Commission's Rules*, Docket No. CCB/CPD 98-40, ATU Petition filed June 22, 1998.

31 GCI Press Release, "GCI Wins Alaska LMDS Rights," March 30, 1998 (Attachment A to ATU Petition).

rules.[32] The FCC should act on this petition promptly.[33] The pricing flexibility we recommend below can meet ATU's needs and would eliminate the cumbersome Part 69 waiver process that is so inhibiting to ILECs' responsiveness to customer needs.

IV. Three Means of Pricing Flexibility

RoR ILECs need pricing flexibility to respond to competition now. Additionally, pricing flexibility improves economic efficiency. USTA proposes a number of pricing flexibility options in its Comments.[34] In this section, we focus on three particular means of pricing flexibility that also are appropriate now for RoR ILECs: (1) elimination of the FCC's "all-or-nothing" rule for multi-study area RoR ILEC participation in NECA pools; (2) contract pricing and optional access pricing plans filed by RoR ILECs, under streamlined conditions; and (3) forbearance from unnecessary regulation.

A. Flexibility in NECA Pool Participation

One means of pricing flexibility that USTA seeks is for the FCC to change its "all-or-nothing" rule regarding a holding company's participation in the common line pools.[35] The current rules require a multi-study area RoR ILEC to participate in the common line pool for all or none of its study areas. Presumably, the FCC is concerned about ILECs' ability to shift costs among study areas and sees the least harm in an "all-or-nothing" rule. The consequence is that a multi-study area RoR ILEC with varied properties (*i.e.*, some suburban areas and some very rural areas) cannot develop a separate price schedule for each property. As a result, in the lower cost study area, the

---

32 Few ILECs have received relief under the Part 69 process to price flexibly. Granted, waivers are eventually approved for the introduction of new rate elements such as "500 service" access which long-distance carriers requested. In the end, all ILECs offering "500 service" access had to file tariffs under a generally applicable set of guidelines. The fact that many ILECs had to seek a waiver from Part 69 to offer a new service that customers wanted is evidence of the ability of FCC rules to stifle creativity and delay new product offerings. Additionally, GTE's request for permission to offer volume and term discounts filed in 1995 is still unanswered by the FCC.

33 The 1996 Act does, however, require the FCC to act upon a petition for forbearance within one year of the filing date. The petition is deemed granted after one year absent any FCC action. 47 USC § 159 (10)(c).

34 USTA Comments at 23-26.

35 USTA Comments at 25.

RoR ILEC cannot respond to competition with a lower common line or traffic-sensitive rate without taking all of its study areas, including the higher cost ones, out of the pool.[36]

Instead, the FCC should allow an RoR ILEC to remove any number of study areas from the pool, subject to cost allocation rules that would guard against cross-subsidy. USTA recognizes that RoR ILECs must forego long term support (LTS) for those properties that exit the pool.[37] These are the same conditions under which other ILECs have exited the pools. Under this proposal, the multi-study area RoR ILEC is not bound by a price averaged across its varied properties, and the higher cost study areas do not have to experience a sharp increase upon mandatory departure from the pool.

Accounting safeguards can be developed to guard against potential subsidy flows. Multi-study area RoR ILECs that partially exit the pool can provide cost allocation manuals to the FCC to ensure that shared costs are not shifted to the study areas that remain in the pool. Tier One ILECs have been filing similar cost allocation manuals to the FCC to address a variety of cross-subsidy concerns. Therefore, established standards are available to draw from for this purpose.

The kinds of cost that may be of interest for the purposes of a partial exit from a NECA pool are general and administrative costs of the holding company, such as executives, marketing, legal, and regulatory. Various means to allocate these costs may include time reporting by employees that provide services for multiple study areas. While network plant is usually specific to a particular study area, other plant such as buildings, computers and vehicles associated with general and administrative costs may be subject to the cost allocation manual.

Additionally, USTA recommends that the FCC permit zone pricing of common line rate elements by RoR ILECs not in NECA pools. Within zones, RoR ILECs would offer the common line elements at the same rate.[38] The same principles that support de-averaging across study areas could support RoR ILECs' ability to de-average rates within study areas; *viz.,* to enable them to respond to competition in those exchanges where competitive pressures are greater.

---

[36] In contrast, price cap ILECs and RoR ILECs that have no properties in NECA pools may develop different tariffed rates for different study areas. They have the benefit of de-averaging their rates.

[37] USTA Comments at 25.

[38] USTA Comments at 24.

B. Contracts and Optional Access Pricing Plans

The second component of pricing flexibility that we recommend is to allow RoR ILECs to offer contract pricing and optional pricing plans for access services.[39] As we described above, RoR ILECs face several competitive risks today. If an ILEC lacks the ability to price access flexibly, an IXC or CAP can easily bypass the RoR ILEC network and serve the few large customers. The ability to offer prices with volume and term — or other — discounts to access customers is important to allow RoR ILECs to respond to such competitive pressures. The financial effect of bypass to an RoR ILEC in a small exchange can be very significant. Our point here is not that bypass be prohibited or limited in any way — such regulations would have only limited effectiveness. Rather, RoR ILECs should be given the pricing tools to enable them to compete in a competitive market in which bypass can and will occur.

Some ILEC opponents may argue that volume and term discounts would be discriminatory.[40] Recall, however, that the Communications Act only prohibits *unreasonable* discrimination.[41] Contracts can be made available to similarly situated customers to meet the nondiscrimination requirements of the Act. Providing the discounts through optional access pricing plans also enables RoR ILECs to offer the same discount to similarly situated customers.

We recommend that RoR ILECs be accorded the ability to offer access services through two types of contracts and optional access pricing plans: (1) one in which the IXC selects a pricing option to meet its needs; and (2) one in which the RoR ILEC offers to retail customers (*e.g.*, a large business customer) lower access charges for its traffic directed to and from the IXC of the customer's choosing.

Optional access pricing plans would be tariffed offerings. Through such pricing plans, an RoR ILEC may propose a variety of prices to customers that purchase the optional pricing package.

---

[39] USTA has envisioned the FCC granting RoR ILECs the ability to offer contracts to individual customers. USTA's proposal and optional access pricing plans are discussed in this section.

[40] Some opponents may also be concerned that the ability to RoR ILECs to offer long-term service plans to customers could inhibit the ability of new competitors to win such customers. Prohibiting the ability to offer contract or optional pricing plans is an inferior solution to this problem. Rather than hold hostage the benefits of pricing flexibility the FCC would better serve consumers by fashioning some remedy to address the role of long-term service plans in light of competitive entry.

[41] 47 USC § 202(a).

These alternative price structures would be offered in the RoR ILEC's tariff in addition to its basic tariffs filed pursuant to the rate structure adopted by the FCC. The optional access pricing plans would be generally available, as tariffed services. Individual contracts would be filed with the FCC and made generally available as well. This pricing freedom allows RoR ILECs to rebalance rates according to their customers' needs and the presence of competition. Part 69 suspension should not be required for an RoR ILEC to file such a contract or an optional access pricing plan. In fact, the Part 69 waiver process is obsolete in this environment.

The FCC is often concerned about the impact of access pricing on competition in the long distance industry. Specifically, most IXCs are not similarly situated to AT&T and do not have the usage to achieve the discounts that AT&T could obtain from an RoR ILEC. A contract or an optional pricing plan from which a large business customer may purchase service, however, does not distort competition among IXCs. On the contrary, it enhances competition among the IXCs for the large customer. Large customers in rural areas may then enjoy long-distance discounts they could not have achieved otherwise because of historically high access rates. Under such a pricing arrangement, the access rates for usage to and from the business customer would be provided at the specified discount, no matter which IXC serves the customer. Contracts and optional pricing plans thus give the business customer a portable access discount it can offer to all IXCs that compete to provide its long distance service. The access discount would likely be enjoyed by an IXC that passes on to the customer a substantial share of that discount.[42]

Contracts and optional access pricing plans will be very beneficial to the IXCs (*qua* IXCs rather than *qua* CLECs), which often complain about high access rates in rural markets.[43] Contract and optional access pricing will enable IXCs to offer lower rates to their customers in all areas of the

---

[42] For both contracts and optional access pricing plans, whether purchased by an IXC or a large customer, the FCC may wish to adopt measures to ensure that rates are not unreasonably discriminatory. Specifically, the FCC could consider application of the "net revenue test" that it developed for AT&T optional calling plans (OCPs) introduced in the 1980s. In this test, the elements of an OCP must demonstrate an increase in revenue that exceeds the increase in costs. This safeguard ensures that customers are covering their cost to be served and that no customer enjoys a greater cost savings than that which can be attributed to it. For an economic analysis of optional calling plans and the net-revenue test, *see* B. Mitchell and I. Vogelsang, *Telecommunications Pricing Theory and Practice*, Cambridge: RAND, 1991.

[43] IXCs may, however oppose contract carriage for access services because as CLECs they would like to arbitrage access and unbundled element rates in debating whether to provide local exchange services. Lower contract prices or optional pricing plan rates may eliminate that opportunity.

country as a result of lower access rates in RoR ILEC markets. RoR ILECs will be able to rebalance their rates through contracts and optional access pricing plans rather than through artificial regulatory forces. The ability of RoR ILECs to offer access services via these mechanisms will go toward ameliorating the IXCs' burden of nationwide rate averaging. Most important, customers in higher cost markets will enjoy lower long distance rates that they might not otherwise experience.

C. Forbearance from Unnecessary Regulation

The third component of pricing flexibility that we propose centers on additional forbearance from unnecessary regulation for RoR ILECs. These companies face minimal regulation before many state commissions. For example, Nebraska has embarked on an experiment of deregulation of small telephone companies with great benefits. The Iowa Utilities Board has refrained from regulating over 150 small ILECs that operate in the state.[44] In Illinois, small ILECs' rates are not subject to investigation unless a complaint is received by a telecommunications carrier that is a customer, or a complaint is filed by the lesser of 5 percent of subscribers or 75 subscribers of the potentially affected access lines.[45] Conflicts between IXCs and ILECs have typically been negotiated among the parties. Generally applicable issues, such as local transport restructure, can be addressed by proceedings involving the industry as a whole.

In a similar vein, we recommend that the FCC reduce its regulatory scrutiny over RoR ILECs. Above we recommended that the FCC allow broad pricing flexibility to RoR ILECs. If regulators retain some control over the wholesale or input prices, such as access, there is less need for pervasive regulation of retail or output prices.

We recommend that RoR ILECs be granted many of the benefits enjoyed by non-dominant carriers. Specifically, we recommend that RoR ILECs be allowed to file revenue-neutral changes in all interstate tariffs on one-days' notice with no cost support. Such tariffs should be presumed lawful. Interested parties would have the opportunity to file complaints with the FCC, which may investigate the tariff in that instance, but the tariffs would remain in effect during such investigation. The tariffs that we envision are in addition to the annual or biennial tariff filings that RoR ILECs

---

[44] Iowa Code §§ 476.96(5) and 476.1.

[45] Illinois Public Utilities Act § 13-504(a).

make for rate-of-return determinations. RoR ILECs should not be limited to filing tariffs on those occasions.[46]

Many RoR ILECs now have the opportunity to file tariffs biennially. RoR ILECs that use the incentive plan under Section 61.38 (b) must file cost data to support rate changes. In between the biennial filings, these ILECs should be allowed to file revenue-neutral charges in tariffs without cost support consistent with our recommendation above.

With the pricing freedom we propose, the RoR ILECs would be able to restructure their access rates in such a way as to recover their costs at prices that meet customers' needs. RoR ILECs may also recover their costs in a more economically efficient manner. The ability of RoR ILECs to price services to enable the ILEC to recover costs where it may, subject to an overall cap, is critical to enabling RoR ILECs to compete in the market. This more flexible regulation, unlike the current system, can product results consistent with a competitive market.

V. Conclusion

While the FCC's access reform NPRM starts with a correct analysis of the situation facing RoR ILECs, it does not contain a comprehensive approach to access restructuring, universal service and pricing flexibility. The FCC is on the right track as it proposes a more economically efficient rate structure for RoR ILECs. But it must move carefully. As our study of rural ILECs shows, access charges are the primary means by which universal service objectives have been met for most RoR ILECs. If the FCC pursues restructuring of SLCs and PICCs prior to termination of the rural transition plan, it should cap the SLC and PICC for RoR ILEC customers at the nationwide average of price cap ILECs' rates to minimize the rate shock to customers.

Pricing flexibility is also integral to access reform as RoR ILECs face competition in their markets, as described earlier. USTA members have offered to unbundle their networks in return for the ability to do contract pricing. As historical revenue sources are challenged by lower-priced alternatives, RoR ILECs must be able to use different means to collect revenues to recover the costs of their networks. Pricing flexibility is not a substitute for universal service and access restructuring, particularly for high cost companies. It does, however, provide an additional means of recovery of

---

[46] RoR ILEC study areas that participate in the NECA pools may not be able to enjoy this benefit.

interstate common line costs for a number of RoR ILECs. Recovery of those costs can be problematic for RoR ILEC customers if rates are allowed to rise according to the formulae for price cap ILECs. To the extent that these high costs are recovered through access charges that exceed those of price cap LECs, RoR ILECs are especially vulnerable to inefficient competition. Pricing flexibility provides a way to reduce this vulnerability without excessive increases in local rates.

Through partial participation in the NECA common line pool, RoR ILECs should have the opportunity to de-average their common line rates among study areas. Partial participation in NECA pools, subject to accounting safeguards to guard against cost shifting, enables RoR ILECs to respond to different competitive pressures in different study areas. De-averaging common line rate elements within study areas also enables RoR ILECs to respond to different competitive pressures. RoR ILECs should be able to offer access contracts and optional access pricing plans to IXCs and to large customers. Contracts and optional access pricing plans that would be aimed at large customers would include the access services related to the traffic they generate. This proposal enables IXCs to compete for the customer by passing through the access discount. Contracts and optional access pricing plans have the effect of rebalancing rates in an alternative fashion to the FCC's mandated restructuring.

Forbearance from the current level of regulatory scrutiny is an improved form of regulation for RoR ILECs. These companies often face lesser regulation before state commissions. USTA's proposal allows RoR ILECs price flexibility to meet customer needs and respond to competition. The standard tariff rates may serve as a cap while IXCs and large customers may contract with an RoR ILEC or select an optional access pricing plan.

The pricing flexibility recommended is reasonable and appropriate for RoR ILECs. It considers the impacts of competition, universal service and access reform on RoR ILECs and their customers. The pricing flexibility proposed allows market forces and RoR ILECs' costs to determine interstate access rate reductions, while not eliminating regulation of RoR ILECs' overall access rates. This is in contrast to the FCC's rigid pricing rules.

I hereby swear and affirm that the statements contained in the attached DECLARATION are true and correct to the best of my knowledge and belief.

Margaret L. Rettle

County of Montgomery

State of Maryland

Subscribed and sworn before me this 14th day of August 1998.

Notary Public

ADRIENNE WELLS VENDIG
NOTARY PUBLIC STATE OF MARYLAND
My Commission Expires September 28, 1998

My commission expires:

TOTAL ALL COMPANIES

State = NATION AVERAGE

PICC/SLC at FCC Cap

			Forecasted Growth	Jul-98	Jul-99	Jul-00	Jul-01
A.	1.	CL Revenue Requirement	5.50%	$ 656,634,004	$ 692,748,874	$ 730,850,062	$ 771,046,815
	2.	+ Line Port 30% (LS RRQ - DEM)		$ 61,486,975	$ 61,486,975	$ 61,486,975	$ 61,486,975
	3.	+TS Mktg Exp	3.00%	$ 3,519,681	$ 3,625,271	$ 3,734,030	$ 3,846,050
	4.	+ USF Contribtion (3.05%)	3.00%	$ 17,911,994	$ 18,449,354	$ 19,002,834	$ 19,572,919
	5.	+Ed/HI Contribution (1.50%)	3.00%	$ 39,958,216	$ 41,156,962	$ 42,391,671	$ 43,663,421
	6.	+ TIC Residual to CL RRQ	6.00%	$ 94,989,219	$ 100,688,572	$ 106,729,887	$ 113,133,680
	7.	Net Total CL Rev Req		$ 874,500,089	$ 918,156,009	$ 964,195,459	$ 1,012,749,862
B.		Demand	Annual Growth				
	1.	Primary Line Residence	2.93%	4,282,417	4,407,892	4,537,043	4,669,979
	2.	Lifeline	2.93%	35,305	36,339	37,404	38,500
	3.	Single Line Business	7.18%	573,459	614,633	658,763	706,063
	4.	Non-Primary Line Res	10.00%	415,269	456,796	502,476	552,724
	5.	Multiline Business	8.67%	728,052	791,174	859,769	934,311
C.		SLC Charges					
	1.	Primary Line Residence		$ 3.50	$ 3.50	$ 3.50	$ 3.50
	2.	Lifeline		$ 3.50	$ 3.50	$ 3.50	$ 3.50
	3.	Single Line Business		$ 3.50	$ 3.50	$ 3.50	$ 3.50
	4.	Non-Primary Line Res		$ 5.00	$ 6.15	$ 7.33	$ 8.55
	5.	Multiline Business		$ 9.00	$ 9.27	$ 9.55	$ 9.83
D.		PICC Charges					
	1.	Primary Line Residence		$ 0.53	$ 1.05	$ 1.58	$ 2.12
	2.	Lifeline		$ 0.53	$ 1.05	$ 1.58	$ 2.12
	3.	Single Line Business		$ 0.53	$ 1.05	$ 1.58	$ 2.12
	4.	Non-Primary Line Res		$ 1.50	$ 2.55	$ 3.62	$ 4.73
	5.	Multiline Business		$ 2.75	$ 4.33	$ 5.96	$ 7.64
E.		Total SLC Revenue		$ 308,975,324	$ 334,194,028	$ 362,529,639	$ 394,412,445
F.		PICC Revenue		$ 62,608,464	$ 116,576,476	$ 182,402,552	$ 255,089,745
G.		Adjusted CCL RRQ (Ln A .7.- Ln E.- Ln F.)		$ 502,916,302	$ 465,385,504	$ 419,263,268	$ 363,247,672
H.		Long Term Support		$ 227,773,543	$ 227,773,543	$ 227,773,543	$ 227,773,543
I.		New Adjusted CCL RRQ - LTS		$ 275,142,759	$ 237,611,961	$ 191,489,725	$ 135,474,129
J.		CCL MOUs					
	1.	Originating		6,903,498,063	7,483,391,900	8,111,996,819	8,793,404,552
	2.	Terminating		8,330,240,223	9,029,980,401	9,788,498,755	10,610,732,650
K.		CCL Rate					
	1.	CCL Rate (Orig & Term)		0.0181	0.0144	0.0107	0.0070
	2.	Term CCL Rate (Orig = $0.01)		0.0247	0.0180	0.0113	0.0070

TOTAL ALL COMPANIES
State = NATION AVERAGE
PICC/SLC at Price Cap Average

			Forecasted Growth	Jul-98	Jul-99	Jul-00	Jul-01
A.	1.	CL Revenue Requirement	5.50%	$ 656,634,004	$ 692,748,874	$ 730,850,062	$ 771,046,815
	2.	+ Line Port 30% (LS RRQ - DEM)		$ -	$ -	$ -	$ -
	3.	+TS Mktg Exp	3.00%	$ -	$ -	$ -	$ -
	4.	+ USF Contribtion (3.05%)	3.00%	$ 17,911,994	$ 18,449,354	$ 19,002,834	$ 19,572,919
	5.	+Ed/HI Contribution (1.50%)	3.00%	$ 39,958,216	$ 41,156,962	$ 42,391,671	$ 43,663,421
	6.	+ TIC Residual to CL RRQ	6.00%	$ -	$ -	$ -	$ -
	7.	Net Total CL Rev Req		$ 714,504,214	$ 752,355,190	$ 792,244,568	$ 834,283,156
B.		Demand	Annual Growth				
	1.	Residence	3.46%	4,697,602	4,860,139	5,028,300	5,202,279
	2.	Lifeline	3.46%	35,821	37,060	38,342	39,669
	3.	Single Line Business	7.18%	573,459	614,633	658,763	706,063
	4.	Multiline Business	8.67%	728,052	791,174	859,769	934,311
C.		SLC Charges					
	1.	Residence		$ 3.50	$ 3.50	$ 3.50	$ 3.50
	2.	Lifeline		$ 3.50	$ 3.50	$ 3.50	$ 3.50
	3.	Single Line Business		$ 3.50	$ 3.50	$ 3.50	$ 3.50
	4.	Multiline Business		$ 7.14	$ 7.11	$ 7.07	$ 7.01
D.		PICC Charges					
	1.	Primary Line Residence		$ 0.53	$ 0.99	$ 1.35	$ 1.62
	2.	Lifeline		$ 0.53	$ 0.99	$ 1.35	$ 1.62
	3.	Single Line Business		$ 0.53	$ 1.01	$ 1.37	$ 1.64
	4.	Multiline Business		$ 2.64	$ 2.82	$ 1.99	$ 1.84
E.		Total SLC Revenue		$ 285,172,826	$ 298,926,302	$ 313,278,085	$ 328,333,289
F.		PICC Revenue		$ 56,816,441	$ 92,377,458	$ 113,394,992	$ 136,443,426
G.		Adjusted CCL RRQ (Ln A .6.- Ln E.- Ln F.)		$ 372,514,946	$ 361,051,430	$ 365,571,491	$ 369,506,442
H.		Long Term Support		$ 227,773,543	$ 227,773,543	$ 227,773,543	$ 227,773,543
I.		New Adjusted CCL RRQ - LTS		$ 144,741,403	$ 133,277,887	$ 137,797,948	$ 141,732,899
J.		CCL MOUs					
	1.	Originating		6,903,498,063	7,483,391,900	8,111,996,819	8,793,404,552
	2.	Terminating		8,330,240,223	9,029,980,401	9,788,498,755	10,610,732,650
K.		CCL Rate					
	1.	New CCL Rate (Orig & Term)		0.0095	0.0081	0.0077	0.0073
	2.	New Term CCL Rate (Orig = $0.01)		0.0095	0.0081	0.0077	0.0073

CERTIFICATE OF SERVICE

I, Theresa Caballero, do certify that on August 17, 1998, copies of the accompanying Comments of the United States Telephone Association were either hand-delivered, or deposited in the U.S. Mail, first-class, postage prepaid to the persons on the attached service list.

Theresa Caballero

Jane Jackson
Chief-Competitive Pricing Division
Federal Communications Commision
Common Carrier Bureau
Room 518
1919 M Street, NW
Washington, DC 20554

ITS, Inc.
1231 20th St., NW
Washington, DC 20036